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Nos. 93-1612, 93-1613

IN THE
Supreme Court of the United States

OCTOBER TERM, 1994

EUGENE LUDWIG,
COMPTROLLER OF THE CURRENCY, *et al.*,
Petitioners,
v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY,
Respondent.

**On Writ of Certiorari to the
United States Court of Appeals
for the Fifth Circuit**

**BRIEF OF *AMICUS CURIAE*
AMERICAN ACADEMY OF ACTUARIES
IN SUPPORT OF RESPONDENT**

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BRIEF OF *AMICUS CURIAE* AMERICAN ACADEMY OF ACTUARIES IN SUPPORT OF RESPONDENT

The American Academy of Actuaries submits this brief as *amicus curiae*, pursuant to Rule 37 of the Rules of the Supreme Court of the United States, in support of the respondent in Nos. 93-1612 and 93-1613, having obtained the written consent of both the petitioners and the respondent to do so. Said written consent accompanies this brief.

STATEMENT OF INTEREST OF *AMICUS CURIAE*

The American Academy of Actuaries (the "Academy") is a nonprofit professional association established in 1965 to provide a common membership organization for actuaries of all specialties (including life insurance) practicing within the United States and to seek greater public recognition for the actuarial profession. To become an

Academy member, an actuary must satisfy rigorous education and experience requirements, including successful completion of a series of examinations in relevant areas of actuarial practice. Membership in the Academy is a requirement in many states to perform certain types of actuarial work. The Academy's primary activities include liaison with federal and state governments, relations with other professions, dissemination of public information about the actuarial profession, and the promulgation and implementation of standards of professional conduct, practice and qualification. The Academy's membership exceeds 11,000 actuaries nationwide.

The Academy has approximately three thousand members who provide actuarial services to life insurance companies; the Academy believes that nearly all of those companies offer fixed or variable annuities among their insurance products. The Academy anticipates that the Court's decision in this case may have a significant effect upon the professional practices of these actuaries, to the extent that annuities are deemed by the Court not to constitute "insurance." Further, the Academy believes that the perspective of its members who work regularly with life insurance products, including annuities, may be useful to the Court as it seeks to determine whether annuities constitute "insurance" for purposes of 12 U.S.C. § 92 (hereinafter "Section 92"). Accordingly, the Academy has a substantial interest in this proceeding.

SUMMARY OF ARGUMENT

Annuities have historically been recognized by insurance experts as a form of insurance. Both annuities and life insurance policies involve transfer of mortality risk, a risk that is evaluated by actuaries in both instances through application of the same mathematical principles and techniques. Actuaries who wish to practice in the life insurance field must pass a series of examinations that includes questions on annuities, and actuarial textbooks on life insurance routinely address annuities. Thus,

for actuarial purposes, life insurance policies and annuities are both forms of insurance.

The fact that annuities involve an investment element as well as an element of mortality risk does not mean that annuities are not a form of insurance. As the Court has recognized, life insurance and annuities are continually evolving as new products are developed. Many forms of life insurance involve significant investment elements and are purchased by consumers for their investment value. To conclude that annuities cannot be "insurance" merely because they may possess some investment value would suggest that life insurance policies with significant investment elements might not be "insurance," a result that the Academy believes cannot be intended by the Court.

States regulate annuities, like life insurance policies, under their insurance laws. If the Court determines that annuities are not "insurance," the Court's determination could call into question states' authority to regulate annuities. Further, a finding that annuities are not "insurance" could lessen the perceived need for actuaries to participate in the development of annuity products; such a result would be harmful to the public because annuities designed and priced without the expert guidance of an actuary would almost certainly be less reliable.

ARGUMENT

In order to address the central issue presented by this case, specifically, whether national banks (wherever located) are permitted by federal law to act as agent in the sale of annuities, the Court must determine whether annuities are or are not a form of "insurance." It is to this narrow issue that the Academy's comments are addressed.[1]

I. THE HISTORIC LINK BETWEEN LIFE INSURANCE AND ANNUITIES

Life insurance, in its most classic form, contemplates that the insured pays a periodic premium to the insurer in exchange for payment by the insurer to a designated beneficiary upon the insured's death. Thus, the risk of death is transferred from the insured to the insurer, insofar as the insurer "gambles" that the insured will die before paying a sufficient premium to cover the cost of the death benefit. *See generally* MacLean, *Life Insurance* at 3-9 (9th Ed. 1962). Life annuities, in their simplest form, require the annuitant to pay a premium to an insurer, which then promises to make regular periodic payments to the annuitant until the time of the annuitant's death. *Id.* at 53. With annuities, the insurer "gambles" that the annuitant will live longer than anticipated, thereby receiving a greater number of payments than the cost to set up the annuity. Thus, both life insurance policies and annuities traditionally have involved a significant element of mortality risk and an acceptance of that risk by the insurer.

Since the inception of the life insurance industry in the United States, life insurance policies and annuities have

[1] The Academy takes no position with regard to the issues of whether Section 92 prohibits national banks from acting as agent for sales of insurance products in communities with more than 5,000 inhabitants or whether the sale of annuities is "necessary to carry on the business of banking" under 12 U.S.C. § 24(7).

been inextricably linked. Both life insurance policies and annuities have traditionally been sold by the insurance companies, and nearly all life insurance companies sell annuities. *Id.* Legal and other authorities on the subject of insurance traditionally view life insurance policies and annuities as mirror images of each other, recognizing both as forms of "insurance." *E.g.*, Harnett and Lesnick, *The Law of Life and Health Insurance* § 1.01 (1993) (noting similarities in adverse contingencies between life insurance policies and annuities); Black and Skipper, *Life Insurance* at 101 (11th Ed. 1987) ("[d]espite the difference in function, annuities are simply another type of insurance and both life insurance and annuities are based on the same fundamental principles").

Further, because both life insurance policies and life annuities require the estimation of mortality rates for purposes of setting premiums, life actuaries have historically been deeply involved in their development and pricing. Indeed, the individual who is generally recognized as the first actuary in the United States, Jacob Shoemaker, was employed by a company with the title, "Pennsylvania Company for Insurance on Lives and Granting Annuities." Moorehead, *Our Yesterdays: the History of the Actuarial Profession* at 4 (1989). In his annual report to the company's board of directors, Mr. Shoemaker specifically observed that life insurance and annuity contracts to be offered by the company " 'will be governed by the same principles (viz.) a combination of the casualties of life with the Interest [*sic*] of money.' " *Id.* at 4-5, *quoting* Actuarial Report of Jacob Shoemaker (1813). The actuarial profession has been involved in determining mortality and interest rates for life insurance policies and annuities ever since. *See* Moorehead, *supra*, at 113-15 (describing efforts by the actuarial profession to develop reasonable life insurance policy and annuity premiums over the last fifty years).

II. THE ACTUARIAL LINK BETWEEN LIFE INSURANCE AND ANNUITIES

An actuary's duties when dealing with life insurance policies and annuities are essentially identical. With both products, the actuary makes use of a pooling technique with regard to prospective purchasers, refers to applicable mortality tables,[2] pinpoints a likely interest rate and, by applying the relevant presumptions to potential purchasers, determines what premium the insurer must charge to avoid a loss on the product. This function is essential to the work of a life actuary. "Annuity theory plays an important role in actuarial calculations because premium payments *to* a life insurance company by a policyholder constitute an *annuity due to the company*." Black and Skipper, *Life Insurance, supra* at 323 (emphasis in original).

Annuity practice is considered by the actuarial profession to be a basic part of life insurance practice. Life actuaries study mortality and interest assumptions for annuities as part of their professional eduction. *See* Associateship and Fellowship Catalog of the Society of Actuaries at 48, 51-52 (Fall Ed. 1994). Actuarial textbooks on life insurance routinely cover annuities as well. *See, e.g.*, Spurgeon, *Life Contingencies* at 31-94 (1951); Jordan, *Society of Actuaries' Textbook on Life Contingencies* at 37-62, 221-36 (1952). In order to obtain academic credentials from the Society of Actuaries, a prerequisite to Academy membership for life actuaries,[3]

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[2] It should be noted that the mortality tables used for life insurance policies and annuities are not identical. This is not because the products differ in underlying principles, but because annuity purchasers have tended to be healthier and longer-lived than the general population and therefore require use of presumptions based on a slightly different set of facts. MacLean, *Life Insurance, supra* at 54; Black and Skipper, *Life Insurance, supra* at 318-19.

[3] To qualify for Academy membership, property and casualty actuaries must obtain academic credentials from the Casualty Actuarial Society; pension actuaries must obtain credentials from

would-be life actuaries must complete a series of examinations that include questions on annuities. Associateship and Fellowship Catalog, *supra* at 15-19.

From an actuarial perspective, it makes no difference whether annuities are fixed or variable for purposes of determining mortality risk. As this Court has recognized, fixed and variable annuities "are calculated by identical principles. Each issuer assumes the risk of mortality from the moment the contract is issued. That risk is an actuarial prognostication that a certain number of annuitants will survive to specified ages." *Securities & Exchange Commission v. Variable Annuity Life Insurance Co.*, 359 U.S. 65, 70 (1959). Admittedly, variable annuities may involve a greater element of investment risk to the annuitant than fixed annuities, insofar as variable annuities issue payments that vary depending on the insurer's investment success. However, for the reasons described in Section III(C) below, the fact that an insurance product has a significant investment element does not, in the Academy's view, mean that the product is not "insurance" and is merely an investment vehicle.

III. LIFE INSURANCE AND ANNUITIES SHARE INVESTMENT VALUE

Petitioners and their *amici* make much of *Securities & Exchange Commission v. Variable Annuity Life Insurance Co., supra,* and its progeny, arguing that variable annuities, at the very least, cannot be considered insurance. This Court in *Helvering v. Le Gierse,* 312 U.S. 531 (1941), defined insurance as involving "risk-shifting and risk-distributing." *Id.* at 539. The Court determined in *Securities & Exchange Commission v. Variable Annuity Life Insurance Co., supra,* that for purposes of registering variable annuities under the Securities Act, "the issuer of a variable annuity that has no element of a fixed return

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the Society of Actuaries or the Joint Board for the Enrollment of Actuaries.

assumes no true risk in the insurance sense." *Id.* at 71. From this, petitioners argue that variable and other annuities cannot be deemed "insurance," because the risk transferred between the insurer and the annuitant is an "investment risk," not an "insurance risk."

The Academy respectfully disagrees with this argument. As the Court has recognized, "life insurance is an evolving institution." *Id.* New products are continually being developed, both in the form of life insurance policies and annuities. Variable life insurance contracts are comparable to variable annuities, in that the death benefits or cash value of the policies vary depending on the insurer's success in the stock market. Black and Skipper, *Life Insurance, supra* at 68-69. Current assumption whole life contracts use current interest rates in cash value determination and make use of an indeterminate premium structure. *Id.* at 71-74. Universal Life contracts allow for flexible premiums and depend heavily on the insurer's investment success to determine the value of the policy. *Id.* at 83-85. Even more traditional life insurance contracts typically are assigned a cash surrender value, and may be used as an investment vehicle. Indeed, *any* life insurance contract that calls for the payment of level premiums contains at least some element of investment. MacLean, *Life Insurance, supra* at 19. For this reason, all insurance policies, and particularly the more innovative policies, can be and often are purchased by consumers for their investment value. Black and Skipper, *Life Insurance, supra* at 26. However, one could not, in the Academy's view, convincingly argue that these products are not "insurance."

Some forms of annuities may be sufficiently investment-oriented that it becomes appropriate for a purchaser to "be afforded the same advantages of disclosure which inure to a mutual fund purchased under § 5 of the Securities Act." *Securities Exchange Commission v. United Benefit Life Insurance Co.*, 387 U.S. 202, 211 (1967). From the Academy's perspective, however, it is the trans-

fer of insurance risk, and not the potential investment value, that makes a product "insurance." When annuities involve mortality risk, they remain essentially insurance, even if they also have attractive investment potential.

IV. STATES SHOULD RETAIN THEIR AUTHORITY TO REGULATE ANNUITIES

A decision by the Court that annuities are not "insurance" for purposes of Section 92 could have other implications as well. As the Court of Appeals correctly observed, the states currently regulate annuities through their insurance codes and regulations. *Variable Annuity Life Insurance Co. v. Clarke*, 1993 U.S. App. LEXIS 21592 (5th Cir. 1993) (Pet. App. 11(a)) (collecting authorities). If the Court were to conclude that annuities are not, in fact, "insurance," the authority of states to regulate their development and sale could be called into question.

Moreover, the mortality risk that is typically associated with annuities renders the setting of annuity premiums a task requiring considerable expertise. Life insurers, and the actuaries who work with them, have the necessary skills and experience to evaluate mortality risk, and to set premiums at appropriate levels. A finding that annuities are not "insurance" could undermine the importance of actuarial participation in the development of annuities, thereby increasing the risk that annuities developed and sold in the future will not be actuarially sound.

"Only a life insurance company can guarantee that a given sum can be scientifically liquidated in equal installments over the duration of a human life." Black and Skipper, *Life Insurance, supra* at 101. The Academy would add that even life insurance companies are only able to do so through the expertise of their actuaries. The Academy urges the Court not to issue a decision in this case that would call into question the unique ability of insurance companies and their actuaries to design annuities.

CONCLUSION

For the foregoing reasons, the Academy respectfully requests that, with respect to the question of whether annuities constitute "insurance," the decision of the Court of Appeals below be affirmed.

Respectfully submitted,

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